STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**03/27/06**	Bill No:	**SB 1619**
Tax:	**Sales and Use**	Author:	**Dutton**
Related Bills:	**AB 236 (Bermudez)** **SB 998 (Margett)**		

BILL SUMMARY

This bill would exempt from the sales and use tax, until January 1, 2012, those gross receipts in excess of $1.131 per gallon on the sale or purchase of fuel and petroleum products to an air common carrier on a domestic flight.

ANALYSIS

Current Law

Under existing law, Section 6385 of the Revenue and Taxation Code (RTC) provides a sales tax exemption for that portion of the sale of fuel and petroleum products sold to a water common carrier that remains on board after the water common carrier reaches its first out-of-state destination. This section additionally provides a sales tax exemption for the sale of tangible personal property, other than fuel and petroleum products, sold to air, water, and rail common carriers when that property is shipped to a point outside this state under specified conditions.

With respect to air common carriers, RTC section 6357.5 provides an exemption for the sale or purchase of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an international flight. Therefore, if an air common carrier's final destination were France, for example, current law would exempt the entire sale of fuel purchased in California, even if that carrier had stops in Los Angeles and New York before reaching its final destination. On the other hand, if the air carrier's final destination was somewhere in the United States, current law would impose tax on the entire sale of the fuel in California.

Proposed Law

This bill would add Section 6357.7 to the RTC to provide an exemption from the computation of the amount of tax on those gross receipts in excess of one dollar and thirteen and one-tenth cents ($1.131) per gallon from the sale or purchase of fuel and petroleum products by an air common carrier on a domestic flight. If enacted, only the first one dollar and thirteen and one-tenth cents ($1.131) per gallon would be subject to tax.

This bill defines the term "domestic flight" to mean a flight whose final destination is a point inside of the United States, including its territories.

This bill would also define the term "air common carrier" to mean a common carrier as defined in Section 23046 of the Business and Profession Code.

This bill would provide that the exemption does <u>not</u> apply to any tax levied pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law, unless approved by the local government that would otherwise receive the revenues derived from the taxes imposed under those laws. The governing body of any county, city, or district that votes to allow the exemption is required to notify the Board no later than December 1, 2006.

This bill would require the Board, beginning January 1, 2008, and annually thereafter, to submit a report to the Legislature on the state fiscal impact of the exemption.

The provisions of the bill would become operative on January 1, 2007, and would remain in effect until January 1, 2012, and as of that date would be repealed.

Background

Until July 15, 1991, sales of fuel and petroleum products to air, water, and rail common carriers were exempt from sales tax when used in the conduct of the carriers' common carrier activities after the first out-of-state destination. The rationale for this exemption was that it made California ports and airports more competitive, and it established consistency in the Sales and Use Tax Law for interstate and foreign commerce sales by exempting that portion of the fuel which was actually transported outside this state prior to any use. However, because of the budget crisis in 1991, this exemption was repealed by Assembly Bill (AB) 2181 (Stats. 1991, Ch. 85) and Senate Bill (SB) 179 (Stats. 1991, Ch. 88).

In 1992, however, AB 2396 (Ch. 905) restored this exemption for fuel and petroleum products, but only with respect to water common carriers, and only until January 1, 1998. The sponsors of that measure, Pacific Merchant Shipping Association, successfully argued before the Legislature that the July 1991 repeal of the exemption had been directly responsible for a decline in the number of ships which bunker in California ports, and that reinstating the exemption would increase bunker activity in California. The sunset date of January 1, 1998 was extended until January 1, 2003 by AB 366 (Stats. 1997, Ch. 615). Subsequent legislation extended the sunset date to January 1, 2014 (Ch. 712, SB 808, Stats. 2003).

Two bills to restore the exemption for air and rail common carriers were introduced in the 1996 Legislative Session. AB 3375 (Olberg) would have restored the exemption for rail common carriers. AB 566 (Kaloogian) would have restored the exemption for air common carriers. According to a Department of Finance analysis of AB 566, "Governor Wilson has proposed a different form of tax relief for the aircraft industry. Under the Governor's proposal, a sales tax exemption would be extended to property that becomes a component part of an exempt aircraft as a result of maintenance, repair, overhaul, or improvement of the aircraft in compliance with FAA requirements." The Governor's proposal was actually enacted in the 1996 Legislative Session by SB 38 (Lockyer, et al., Stats. 1996, Ch. 954) which, among other things, included the sales tax exemption for the component parts.

Four recent bills would also have exempted from sales tax that portion of the sale

of fuel and petroleum products sold to an air common carrier that is left on board after the air common carrier reaches its first out-of-state destination:

- AB 1800 (Machado, 1998) was held under submission in the Assembly Appropriations Committee.
- AB 2470 (Wiggins, 2000) died in Assembly Revenue and Taxation Committee.
- SB 1510 (Knight, 2002) died in Senate Revenue and Taxation Committee.
- SB 998 (Margett), introduced during 2005 Legislative Session, died in Senate Revenue and Taxation Committee.

Two other bills, similar to this bill, would have exempted from the sales and use tax, those gross receipts in excess of a specified amount per gallon on the sale or purchase of fuel and petroleum products by an air common carrier on a domestic flight:

- AB 2897 (Wiggins, 2002) would have exempted from the sales and use tax, those gross receipts in excess of $0.50 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill was held under submission in the Assembly Appropriations Committee.
- AB 236 (Bermudez), introduced in 2005, would have exempted from the sales and use tax, those gross receipts in excess of $0.632 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill died in Assembly Revenue and Taxation Committee.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by United Airlines to create an exemption for sales of fuel to air common carriers since the exemption previously afforded to sales of fuel to air common carriers was repealed in 1991 due to budget constraints. According to the sponsor of the bill, the state’s high tax rate, coupled with the excessive cost of fuel per gallon, is having a dramatic impact on the airline industry’s activities in California.
2. **The March 27 amendments** do the following: 1) specify that the exemption from the sales and use tax applies to those gross receipts *in excess of $1.131 per gallon* on the sale or purchase of fuel and petroleum products by an air common carrier on a domestic flight; 2) provide that the exemption does not apply to any tax levied pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law or Transactions and Use Tax Law, unless the governing body of any county, city, or district votes to allow the exemption; and 3) delete the requirement that an exemption certificate contain the air common carrier’s seller’s permit number or fuel exemption registration number.
3. **The exemption certificate provisions should be added back.** Under subdivision (b) of the proposed RTC section 6357.7, the recent amendments deleted the requirement for the air common carrier to state, in writing, the quantity of fuel and petroleum products claimed as exempt and include their seller’s permit number or fuel exemption registration number. Board staff believes the provisions should remain in the bill.

   First, these same provisions are contained in existing law for exemptions on the sale of fuel sold to water common carriers (RTC section 6385) and foreign air carriers (RTC section 6357.5). Second, the purpose of this information is for the purchaser to certify, in writing, that it is lawfully operating as an air common carrier and that the property is being purchased for use in the conduct of its business as an air common carrier. By providing a seller's permit number or fuel exemption registration number, the Board (and the seller) can verify that the purchaser is an air common carrier, and, in the event a taxable use is made of the fuel, the purchaser can report its sales tax liability on its sales tax or fuel tax return.

With respect to the seller, this information is critical in documenting both the exempt sale of property and the exempt sale of property to a qualified person. When the seller accepts a completed, timely submitted exemption certificate in good faith, the seller is relieved of the sales tax liability should the purchaser subsequently make a taxable use of the property. Board staff recommends that these provisions be added back to the bill as they are consistent with existing law and necessary for the Board to administer properly the exemption.

4. **Definition of air common carrier.** This bill defines an air common carrier to mean "a person engaged in regularly scheduled air transportation between fixed termini under a certificate of public convenience and necessity issued by the Civil Aeronautics Board, or its successor, or the Public Utilities Commission, or its successor, and 'airplane' or 'common carrier airplane' means an airplane operated in air transportation by an air common carrier." Would this definition include charter carriers, private carriers, or contract carriers? Board staff notes that the definition is under Division 9, *Alcoholic Beverages*, Chapter 1, *General Provisions and Definitions* of the California Business and Professions Code, and uses the term "air common carrier" which is being defined. Moreover, since the Civil Aeronautics Board was abolished in December 1984, the language appears outdated. Since air common carriers are regulated under the U.S. Department of Transportation, Federal Aviation Administration, perhaps the definition should contain a certain reference to an air common carrier pursuant to the FAA regulation.

5. **Local tax provisions.** This bill provides that the proposed exemption will not apply to any tax levied pursuant to Bradley-Burns Uniform Local Tax law or Transactions and Use Tax law, unless approved by the local government that would otherwise receive the revenues derived from the taxes imposed under these laws. This bill also provides that the governing body of any county, city, or district that votes to allow the exemption is required to notify the Board by December 1, 2006. There appears to be an inconsistency between these two provisions. It's not clear whether "local government" would mean the people of the local jurisdiction voting on the measure or the governing body. Because the one provision states the governing body allowing the exemption shall notify the Board, it would appear that the approval would be by the governing body, and not the local electorate. Also, the time frame to place a measure on the ballot and notify the Board by December 1, 2006 is tight. Board staff notes other bills have contained similar provisions authorizing a governing body to allow an exemption. The language in those bills were as follows:

   (h) Notwithstanding any provision of the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)) or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)), the exemption established by this section shall not apply with respect to any tax levied by a county, city, city and county, or district pursuant to, or in accordance with, either of these laws, unless the governing body of the county, city, or district votes to have the exemption apply.

6. **Recent amendments deleted provisions requiring that the fuel and petroleum products be sold for immediate consumption or shipment.** The recent amendments deleted the requirement that fuel and petroleum products be sold to an air common carrier for immediate consumption or shipment on a domestic flight and not for storage. Board staff is currently evaluating whether this amendment would pose problems in administering the exemption. Board staff will work with the author's office to resolve any concerns or issues.

7. **The Board would not have actual data on aircraft fuel sold to air common carrier qualifying for the exemption.** This bill would require the Board, on January 1, 2008, and annually thereafter, to submit a report to the Legislature setting forth the state fiscal impact of the exemption. This information is not always segregated, but reported as "Other" and not separately identified.

   The Board would estimate the revenue impact of this tax expenditure and use independent data sources, rather than tax returns, in preparing the revenue estimates.

COST ESTIMATE

Some costs would be incurred in notifying affected taxpayers, modifying tax returns, revising regulations and pamphlets, and answering inquiries from industry and the public. In addition, because of the potential for a partial tax exemption, with some local governments opting in on the exemption, administrative costs would also be incurred in computer programming, return analysis, and return processing. A detailed cost estimate is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

According to the U.S. Energy Information Administration (EIA), total sales of jet fuel in California for the year 2004 were 3.7 billion gallons. Approximately 10 percent or 370 million gallons of jet fuel sold in California is for military use. Therefore, in 2004, 3.3 billion gallons (3,700 million – 370 million) of jet fuel was used by commercial air carriers. According to the Bureau of Transportation Statistics, total gallonage consumed in the U.S. in 2003 was 17.8 billion gallons. The fuel consumed by international flights accounts for 4.8 billion gallons, which comprises 27 percent (4.8 billion gallons / 17.8 billion gallons) of jet fuel consumed.

Currently, expenditures on fuel for international flights are exempt from sales and use tax. Assuming that jet fuel usage in California is consistent with the national average, the fuel used for domestic flights is 2.4 billion gallons (3.3 billion gallons X 73 percent). As of April 16, 2006, the spot price of jet fuel in Los Angeles was $2.10 per gallon. This bill would exempt that portion of the price over $1.131 per gallon, or $0.969 per gallon. Therefore, the total annual expenditures that qualify under this bill are estimated to be $2.3 billion (2.4 billion gallons X $0.969).

Revenue Summary

The revenue impact of exempting $2.3 billion ($2.3 billion X 6.25 percent) in jet fuel sales in California is as follows:

	Revenue Loss (in millions)
State (5.00 %)	115.0
Fiscal Recovery Fund (0.25%)	5.8
Local Revenue Fund (0.5%)	11.5
Public Safety Fund (0.5%)	11.5
Total	143.8

Qualifying Remarks

The price of petroleum is extremely volatile. The estimate above is based upon the actual price currently available for 2006 in Los Angeles, California.

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